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EX PARTE

February 3, 2003

ELECTRONICALLY FILED

Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket Nos. 01-338; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 96-98; Appropriate Framework of Broadband Access to the Internet Over Wireline Facilities, CC Docket No. 02-33.*

Dear Ms. Dortch:

I am writing on behalf of AT&T Corp in the above-captioned matters. Throughout these proceedings, the Bell Operating Companies have waged a relentless campaign to eliminate unbundled access to one or more of the unbundled network elements ("UNEs") that comprise the UNE platform that is used by their competitors to provide service to millions of previously-captive residential and small business customers. But the record in these proceedings now overwhelmingly establishes impairment, on a national basis, with respect to each of the elements that the Commission has previously defined as UNEs, including those that when taken together comprise the UNE platform.[1] The Commission should therefore confirm that all of the previously defined UNEs will remain available[2] and eliminate existing use and commingling

[1] *See generally* Robert D. Willig, "Determining 'Impairment' Using the *Horizontal Merger Guidelines* Entry Analysis" ("*Willig Merger Guidelines Analysis*") (attached to 12/03/02 AT&T *Ex Parte* Letter); *Ex Parte* Letter from Judge Robert Bork to Chairman Michael Powell, at 6-8 (filed Jan. 10, 2002) ("*Bork Antitrust Ex Parte*").

[2] As AT&T and other competing carriers have recognized, there are some limited circumstances in which unbundling of certain network elements may no longer be necessary. *See, e.g., Ex Parte* Letter from Joan Marsh (AT&T) to Marlene Dortch (filed Nov. 25, 2002) (noting, for example, that competitors may be able economically to self-supply high capacity loops that carry more than 3 DS-3s of traffic).

restrictions.[3] In so doing, the Commission could also issue guidance concerning its findings of impairment and the conditions it deems necessary to abate that impairment. The Commission should then, on a going forward basis, rely on the state commissions to conduct such proceedings as they deem necessary to determine, based on local market circumstances, when incumbents should be relieved of particular unbundling obligations. This will ensure that competitors that face impairment without access to network elements will be able to continue to lease those elements at cost-based rates as mandated by the Act and *USTA* v. *FCC*,[4] while also ensuring that such mandated unbundling arrangements cease on a granular basis as soon as impairments with respect to individual elements end on a similarly granular basis. This is the only approach consistent with the Act's requirements and the record in these proceedings.

And that is why in recent weeks some of the Bells have begun to abandon their "all-or-nothing" claims that the Commission can eliminate one or more network elements across the board in favor of new, but equally destructive and unlawful assaults on competition. The real issue, these Bells now claim, is not the UNE platform, but new "broadband" use restrictions that the Bells urge the Commission to impose. In a January 17, 2003 *ex parte* letter, Verizon General Counsel William Barr argues that a "service-by-service" impairment analysis is required and that competitive carriers are not impaired in the provision of "broadband" services, which he defines first as any service delivered at a speed greater than 64 kilobits per second ("kbps") and later in the same letter as any service delivered using "packetized technology" or at a speed greater than 200 Kbps.[5] And even more recently, Verizon executives have suggested that competitive carriers should be limited to only 64 Kbps of bandwidth, *regardless of impairment*, in order to provide the Bells with sufficient incentives to upgrade their networks.

As the Bells well know, these "broadband" use restrictions would put an end to most local competition. By definition, any such restriction would eliminate *all* intramodal data competition and thereby remove a critical constraint on the Bells' demonstrated incentives and ability to exercise market power to protect their legacy second line, dial-up Internet and dedicated access services. But these restrictions would also signal an end to most local voice competition, as the Bells would then be the only carriers able to offer mass market consumers the full suite of services that can be (and already are) offered over the existing copper-based loop plant.[6] Fortunately for consumers, however, Verizon's broadband use restriction proposal cannot be reconciled with the record evidence or the law under either of the theories that Verizon advances.

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[3] *See*, *e.g.*, *Ex Parte* Letter from Joan Marsh (AT&T) to Marlene Dortch (filed December 23, 2002); *Ex Parte* Letter from Joan Marsh (AT&T) to Marlene Dortch (filed January 16, 2003).

[4] *USTA* v. *FCC,* 290 F.3d 415 (D.C. Cir. 2002) ("*USTA*").

[5] *See Ex Parte* Letter from William Barr (Verizon) to Chairmen Michael Powell (January 17, 2003) ("*1/17/03 Verizon Broadband Ex Parte*").

[6] *See, e.g., Ex Parte* Letter from David L. Lawson (counsel for AT&T) to Marlene Dortch (filed Dec. 23, 2002) ("*12/23 AT&T Broadband Ex Parte*").

Verizon's Service-by-Service Impairment Theory. Verizon suggests that the Commission has already determined that impairment must always be assessed service by service and that any failure to conduct a separate impairment analysis for broadband services would meet with certain reversal. The reality is quite different. Contrary to Verizon's suggestion, the Commission has never determined that a service-by-service inquiry should be the norm. Indeed, the Commission has employed a service-by-service approach exactly once in support of its *interim* use restriction ruling, and there only in recognition of the unique legal status of exchange access services. *See Supplemental Order Clarification* ¶ 14 ("[t]he exchange access market occupies a different *legal* category from the market for telephone services") (emphasis added). There are, of course, no separate legal categories for 64 (or 200) Kpbs services and "faster" services. *See*, *e.g.*, *ASCENT* v. *FCC*, 235 F.3d 662, 668 (2001) ("As the Commission concedes, Congress did not treat advanced services differently from other telecommunications services"); *See Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 13 F.C.C.R. 24,012, ¶ 11 (1998) ("the pro-competitive provisions of the 1996 Act apply equally to advanced services and to circuit-switched voice services. Congress made clear that the 1996 Act is technologically neutral and is designed to ensure competition in all telecommunications markets").[7]

Moreover, the Commission made abundantly clear in the *Supplemental Order Clarification* that a service-by-service approach likely would *not* be appropriate where, as here, the assertedly separate "markets" are "interrelated."[8] To the extent that competitive carriers cannot economically deploy local loops – as the record in these proceedings establishes in all but a small handful of instances that do not at all relate to the services provided to mass-market customers – they are necessarily impaired with regard to both narrowband and broadband services provided over those loops. That is particularly true given the insurmountable cost advantage the Bells would enjoy if they could recover the economic costs of their loops (and other elements) from both voice and data services revenues, but could require their competitors to recover those same economic costs solely from traditional voice services and revenues. Moreover, as the Commission has repeatedly recognized (and as the Bells continue to trumpet),[9]

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[7] *See also id*. ("We therefore conclude that incumbent LECs are subject to section 251(c) in their provision of advanced services. Specifically, we find that incumbent LECs are subject to the interconnection obligations of sections 251(a) and 251(c)(2) with respect to both their circuit-switched and packet-switched networks. We also clarify that the facilities and equipment used by incumbent LECs to provide advanced services are network elements and subject to the obligations in section 251(c)(3). Thus, for example, all incumbent LECs must provide requesting telecommunications carriers with unbundled loops capable of transporting high-speed digital signals").

[8] Supplemental Order Clarification, *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd. 9587, ¶16 (2000).

[9] *See*, *e.g.*, BellSouth Investor News, at 5 (describing Complete Choice package, including DSL) (available at http://www.bellsouth.com/investor/pdf/4q02p_news.pdf); Comments of AT&T, Willig Dec. ¶¶ 185-86, (CC Docket No. 01-337, filed Mar. 1, 2002); *see also* "New Phone Twist: Switch Local Service and Lose Your DSL, Wall Street Journal, January 30, 2003 at B1 ("Marilyn Hildebrandt was a customer of big local phone company SBC for both local service and a high-speed Internet connection known as DSL. But she got an ugly surprise when she switched her local voice-calling service to WorldCom's MCI to take advantage of a lower rate: SBC turned off her Internet

customers are increasingly *demanding* both voice and data services. Competing carriers are thus plainly impaired in their ability to provide voice services without access to fully functional unbundled network elements over which they can also provide the other services that consumers demand and that the Bells can provide. Thus, Verizon's claim that "the broadband market" is a "separate and distinct market" – and it is perfectly absurd to suggest that 64 Kpbs services are in a separate relevant market from, say, 100 Kpbs services – adds nothing. The relevant consideration is the interrelationship between narrowband and broadband services, and it is that interrelationship, *not* any academic consideration of market definition, that renders Verizon's proposal to conduct entirely separate "narrowband" and "broadband" impairment analyses irrational (and hence unlawful).

Contrary to Verizon's suggestion, the court of appeals went out of its way to preserve the Commission's discretion to reject just such irrational service-by-service impairment proposals. The *CompTel*[10] court expressly declined to assess whether "the Act as a whole []or § 252(d)(2)(B) in particular *requires* that impairment findings be service-by-service or that the UNE mandates be confined to services as to which such a finding has been made."[11] Rather, the Court "tr[ied] only to answer the question of whether the Act *bars* such service-by-service distinctions."[12] At most, therefore, the *CompTel* decision merely *permits* a service-by-service inquiry, and only in appropriate circumstances; it in no way *requires* any such inquiry.

In any event, the records in these proceedings confirm that, even should the Commission believe it appropriate to engage in a broadband-specific inquiry, competitive carriers are obviously and materially "impaired" without access to the full capabilities of copper-based loops, whether they are all copper or copper-fiber hybrid. In this regard, Verizon's extended discussion of retail competition is not an "impairment" analysis at all. As the Commission and the courts have consistently held, an impairment analysis addresses the need of competitive carriers to obtain *wholesale* inputs from incumbent LECs. As the Supreme Court stressed in *Iowa Utilities Board*, in assessing impairment, the Commission must therefore focus on the extent to which an alternative facility is "availab[le] . . . outside the incumbent's network," whether through economically feasible self-deployment or purchase from a competitive third party wholesaler. And whether the service in question is called "broadband" or "narrowband," the answer is categorically "no" for loops used to serve residential and small business

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line. She couldn't get it back until she agreed to return to SBC for all local service. . . . Many other DSL customers have had similar trouble. MCI last year lost about 100,000 potential local-service customers when the company was told by the Bells that these customers would lose their DSL connection if they made the switch, says James Lewis, MCI's senior vice president for state public policy. Now, MCI doesn't even try to sell its local service to such customers, Lewis says").

[10] *Competitive Telecomm. Ass'n* v. *FCC*, 309 F.3d 8 (2002) ("*CompTel*").

[11] *Id.* at 12 (emphasis in original).

[12] *Id.* (emphasis in original).

customers.[13] Whether copper or copper-fiber hybrid, these local loops are quintessential bottleneck facilities because they require enormous sunk costs and are characterized by steep scale and scope economies and first mover advantages that new entrants simply cannot match.[14]

For these same reasons, the relevant market, whatever its precise delineation, cannot be considered "contestable." Although the threat of potential entry can, in some circumstances, discipline the prices charged by even a monopoly provider, "[c]entral to the contestability result is the assumption that no costs are sunk."[15] Absent such sunk costs, a potential rival can engage in "hit-and-run" entry should the incumbent try to increase prices above competitive levels. However, where, as here, there is no question that competitive loop construction requires substantial sunk costs, such targeted entry is not possible because the investment is stranded upon exit. Likewise, markets are only contestable where entrants have the "same cost at each level of output."[16] But the record here is again uncontested that competitive carriers face substantial "second mover" disadvantages that force them to bear substantial costs that the Bells did not.[17] The Commission has recognized precisely these points,[18] and there is accordingly no

[13] No party to these proceedings seriously contends that requesting carriers are not impaired without access to *all-copper* loops. Verizon's argument thus reaches the height of absurdity when it claims that competitive carriers would lose their ability to provide broadband services even for all-copper loops (after a short "transition" period). *1/17/03 Verizon Ex Parte* at 6. But the record is also unrebutted that competitors' impairments with respect to copper-fiber hybrid loops equipped with so-called "NGDLC" technology are, if anything, *greater* than those for all-copper loops. Competitors that do not have access to "entire" loops that provide connectivity all the way from a customer's premises to the ILEC's central office can only provide DSL service by accessing the copper *sub*loop at a remote location. In order to do so, the competitor faces exorbitant per-unit costs for its remote collocation and equipment, as well as additional costs to connect its remote collocation to those subloops and for dedicated transport to bring the traffic from such loops to its own switch. Accordingly, the practical and economic impairment relating to such loops is at least as great as the impairment for "ordinary" loops.

[14] *See, e.g.*, *Willig Merger Guidelines Analysis* at 8-12; *Bork Antitrust Ex Parte* at 2-8.

[15] Richard Gilbert, *Mobility Barriers and the Value of Incumbency*, in I HANDBOOK OF INDUSTRIAL ORGANIZATION 527 (Richard Schmalensee and Robert Willig, eds. 1989). *See generally* William J. Baumol, John C. Panzar, & Robert D. Willig, CONTESTABLE MARKETS & THEORY OF INDUSTRY STRUCTURE 279-309 (1982); Jean Tirole, THE THEORY OF INDUSTRIAL ORGANIZATION 314-15 (1988).

[16] Richard Gilbert, *Mobility Barriers and the Value of Incumbency*, in I HANDBOOK OF INDUSTRIAL ORGANIZATION 527 (Richard Schmalensee and Robert Willig, eds. 1989).

[17] The Bells, to be sure, have attempted to discount such disadvantages and to claim that incumbents cannot be "held accountable" for cost disadvantages that are not their "fault;" however, the Bells cannot deny the existence of their first mover advantages.

[18] *See, e.g.*, *UNE Remand Order* ¶ 77 ("It is generally recognized that the need to incur sunk costs can constitute a barrier to entry. Specifically, where an incumbent has already deployed sunk facilities to serve all customers, a competitive LEC may be unwilling to sink the costs of duplicative facilities, either because it may be unable to lure customers away from the incumbent and generate enough revenue to recover these sunk costs, or because resulting competition between itself and the incumbent LEC would drive prices so low that, even if the competitive LEC won a significant number of customers, it would still be unable to recover its sunk costs. In such situations, the incumbent has a "first mover" advantage"). *See also Ex Parte* Letter from C. Frederick Beckner (counsel for AT&T) to Marlene Dortch (filed Jan. 31, 2002).

possible "contestability" justification for a finding that competing carriers are not impaired in the provision of non-voice services.

Merely pointing to the existence of cable modem competition does not change anything about this analysis.[19] Cable obviously provides no alternative to the Bells' loops for competitive carriers that could abate impairment – no cable company even makes its "loop" facilities available to competitive carriers. And, in *USTA*, the court expressly rejected the notion the Act's "impair" standard requires an "essential facilities"-type test that would require a showing that *no* entry is possible. Instead, *USTA* stated only that a unbundled network element should have "some degree" of the "characteristics" of a "natural monopoly."[20] Likewise, in *Verizon Tel. Cos. v. FCC*,[21] the Supreme Court held that the Act is intended to allow "hundreds" of new entrants to access elements that are "costly to duplicate" even if there are some "large competitive carriers" with the "resources" to replicate the elements economically. Indeed, the Bells themselves have conceded that "the mere presence of a single competitive facility in a particular market [does not] necessarily preclude[] a finding of impairment in that market."[22]

Unless scale economies are sufficiently attenuated that "*multiple*" carriers can profitably duplicate the facility in question – and they clearly are not with respect to loop facilities that serve residences and small businesses – competitive carriers are impaired without unbundled access to the incumbents' facilities.[23] Any other finding would be directly contrary to the record evidence and any rule limiting access to those loop facilities would be inconsistent with the Act's recognized purpose to facilitate sufficient competition to drive rates towards costs.[24] The Bells' argument is also contrary to established antitrust doctrine, which recognizes that entry is not "sufficient" unless "*multiple entry generally is possible* and *individual entrants may flexibly choose their scale*."[25] Not even Verizon would argue that multiple competitive telecommunications carriers could hope to duplicate a cable company's broadband entry costs, given the enormous economies of scope that cable operators enjoy between video programming services and high-speed Internet access (and other) services provided over the same wires. In

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[19] *1/17/03 Verizon Broadband Ex Parte* at 4.

[20] *Id.*

[21] 122 S. Ct. 1646, 1672 & n.27 (2002).

[22] SBC Reply Comments, CC Docket 01-338 at 10 (filed July 17, 2002).

[23] *USTA*, 290 F.3d at 426-28.

[24] *UNE Remand Order*, 15 FCC Rcd. 3696, ¶ 55 (1999) (eliminating unbundling where there is only one alternative to the incumbent carrier would create "stagnant duopolies" that would defeat the Act's objective of "creat[ing] competition among multiple providers of local service that would drive down prices to competitive levels"). *See also EchoStar-DirecTV Merger Order*, 17 FCC Rcd. 20559, ¶ 103 (2002) ("[E]xisting antitrust doctrine suggests that a merger to duopoly or monopoly faces a strong presumption of illegality.").

[25] *Horizontal Merger Guidelines* § 3.4 (emphasis added).

short, Verizon's extended discussion of retail broadband competition in no way supports the "no broadband impairment" finding that the Bells seek.

But even if impairment analysis and questions of wholesale unbundling did turn on the scope of retail competition, Verizon paints a startlingly unrealistic picture of the competitive constraints on the Bells' market power. In particular, Verizon simply ignores the Bells' unique anticompetitive incentives, as well as the overwhelming record evidence that demonstrates that existing and foreseeable levels of retail competition between cable modem service and Bell-only provided DSL service will *not* result in competitive rates for DSL services.[26] The Bells do not have efficient incentives to compete fully when it comes to broadband services. As the Bells have acknowledged, broadband services "are increasingly likely to cannibalize the traditional services offered by incumbent LECs."[27] For example, one "cost[]" of DSL is the fact that "about 30% of new DSL subscribers give up a second phone line" which earns the incumbent LECs higher margins than DSL.[28] Similarly, DSL is a substitute for premium-priced T1, fractional T1, and ISDN services that the incumbent LECs provide to small businesses.[29]

Because of this "cannibalization" effect, the Bells' profit maximizing price for DSL will not be the competitive price, but a higher price. In pricing DSL, the Bells want to price DSL high enough to slow the migration from legacy Bell services to DSL, but not too high to cause mass customer migration to cable. And the Bells' ability to retain and gain customers notwithstanding 25 percent DSL price hikes that were not matched by cable confirms that the Bells unquestionably have the power to sustain enormous price increases even where they face cable competition.[30] That is unsurprising. Cable modem services are not perfect substitutes for the Bells' DSL services because most cable providers cannot match the Bells' voice/DSL bundle.

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[26] Although Verizon points to competition from satellite and fixed wireless, no one seriously believes that these platforms are remotely adequate substitutes for the vast majority of mass-market consumers or that either platform does today or will in the near future place any real competitive pressure on the Bells.

[27] BellSouth Reply Comments, Att. 1, NERA Reply Report ¶ 167 (CC Docket 01-338, filed July 17, 2002). *See also* Goldman Sachs, *Telecom Services*, at 15 (June 11, 2002) ("a negative side effect of adding a DSL subscriber is the potential loss of a second line that the customer had previously subscribed to. SBC estimates that as much as one-half of customers with second lines that sign up for DSL service disconnect their second lines, Verizon estimates that this figure is closer to three-quarters. . . . Second lines generate over $25 per month in revenue and come at a very low incremental cost to the provider, implying very high returns. Alternatively, DSL requires significant upfront acquisition costs as well as infrastructure costs. . . . A DSL subscriber often comes at the expense of a disconnected second line, which means $25 in high-margin revenues are lost.").

[28] BellSouth Reply Comments, Harris Reply Dec., Att. 2 (DSL Business Case) at 3 (CC Docket 01-338, filed July 17, 2002).

[29] Yankee Report (August 2002).

[30] After the collapse of the data LEC industry, the Bells responded by raising their prices by 25% and ending the prior practice in which their retail services that used the lowest-speed Internet access service had been priced at the same level as cable modem service. *See 12/23 AT&T Broadband Ex Parte* (citing Comments of AT&T, Willig Dec. ¶¶ 21-23, 102-13, (CC Docket No. 01-337, filed Mar. 1, 2002)).

And, even if they were, it is established antitrust economics that duopoly can rarely be counted on to produce competitive market incentives.[31] For these reasons, when the Bells raise prices for DSL, they both increase the margins on that service *and* diminish the incentives of current second line/T1 subscribers to switch to DSL, thereby increasing revenue from those legacy services and overall Bell profits.[32] And denying competitive carriers the ability to offer DSL service forecloses those carriers from competing for the growing number of customers that demand voice and data services over a single line from a single provider – as the Bells' economists have recognized.[33]

Verizon also grossly exaggerates the level of cable modem competition for small business customers. The evidence shows that cable is not generally available in business districts at all. Rather, small business customers that have access to cable are in suburban areas that contain or are immediately adjacent to residences. Thus, it is reported that "[m]ore than 80 percent of midsize and small businesses are sufficiently close to a telephone-switching office to subscribe to DSL, whereas cable, having started out as an entertainment medium, reaches fewer than 20 percent of such businesses in the United States."[34] Perhaps the best evidence that DSL generally does not face facilities-based competition for small businesses is the Bells' DSL pricing – the same or similar broadband services provided to businesses are much more expensive than the services provided to residential customers.[35]

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[31] *See EchoStar-DirecTV Merger Order*, 17 FCC Rcd. 20559, ¶ 103 (2002) ("[E]xisting antitrust doctrine suggests that a merger to duopoly or monopoly faces a strong presumption of illegality."). Of course, cable service is not even available in many places. *See Third Section 706 Report*, App. C, Table 9. For example, "forty-five percent of Californians that live in cities with broadband service have DSL service as their only broadband option." California Comments at 28 (CC Docket No. 02-33, filed May 3, 2002).

[32] It is presumably for this reason that the Bells have begun to state publicly that DSL is priced "too low." Vikas Bajaj, *Phone, Broadband Prices Too Low, Verizon Exec Says*, Dallas Morning News (June 5, 2002) ("Digital subscriber lines, which cost about $50 a month today, should be 40 percent to 50 percent more expensive, [Verizon's Vice Chairman and President] told reporters at a news conference.").

[33] *See* Verizon Reply, Kahn-Tardiff Reply Dec. ¶ 39 (CC Docket No. 01-338, filed July 17, 2002) (stating that "competitors will need to offer both voice and broadband services" and that they have "long agreed with [AT&T's] position that carriers need to offer packages of services if they are to compete successfully.").

[34] *DSL Will Win Where It Matters*, McKinsey & Co. (July 2001). Indeed, the source for Verizon's claims corroborates this figure and shows that only a small minority of small business customers can be served with existing cable facilities. *See Ex Parte* Letter of Edward Shakin (Verizon) to Marlene Dortch, at n.8 (filed Jan. 15, 2003) (only about 2.5M out of 10.5M medium and small businesses are served with existing cable facilities).

[35] For example, Qwest offers 256 kbps residential DSL at $39.95, but charges between $79 and $139 per month for 256 kbps business DSL. *Compare* http://qwest.com/residential/products/dsl/index.html *with* http://www.qdslonline.com/prod/offer.html). "T1 and fractional T1 continue to prosper. ILEC sales forces are motivated to sell T1 first and DSL second. . . . The ILECs have done very little to push DSL to small businesses." Yankee Report at 3 (August 2002). Overall, "[e]ven though business subscribers only represent 23% of the total DSL subscribers, they comprise 56% of all DSL revenues in the US . . . . On average a business customer's DSL service will amount to a $200.00 charge monthly." 2002 In-Stat Report.

Thus, it should be clear not only that competing carriers are impaired without the ability to offer broadband services over Bell loops, but that both retail data *and voice* competition, and, of course, mass-market consumers would be severely harmed by Verizon's broadband use restriction.

Verizon's Broadband Investment Theory. Verizon's recent claim that, notwithstanding demonstrated impairment, the bandwidth available over unbundled loops could be artificially capped below existing capabilities on a "broadband investment" theory is equally infirm. At the outset, any consideration of bandwidth or other investment incentive-based limits on unbundling rights must acknowledge that the Bells' "broadband investment" claims are themselves exceedingly weak. Invoking visions of 100 megabit per second ("Mbps") residential broadband services, Verizon and other Bells incessantly threaten that they will put a hold on investment unless and until the Commission frees them from all "broadband" regulation. The Bells have employed that strong-arm tactic with some success in state regulatory proceedings, and those experiences should serve as a cautionary tale. As state regulators have learned, the broadband investments the Bells claim will follow regulatory relief that could not otherwise be justified never seem to materialize. The reason for that is simple. The Bells face neither competitive pressure nor consumer demand to deliver services faster than the very high speed DSL-based services that can be supported by today's ordinary copper and hybrid copper/fiber loops. Moreover, the record here demonstrates both that unbundling obligations that reflect properly implemented forward-looking cost-based pricing *do* replicate competitive market returns and provide ample incentives for bandwidth-enhancing investments. Further, it shows, and the Supreme Court has confirmed, that the competition enabled by such unbundling obligations encourages, rather than discourages, Bell (and competing carrier) investments.[36] There is thus little to be gained in the way of investment – and much to be lost in the way of reduced competition – from unbundling cutbacks or other "broadband" deregulation that would impair competing providers' ability to offer both traditional and advanced services.

But even if there was something to the Bells' premise that unbundling obligations destroy their incentives to make *new* and particularly risky investments, that could not support Verizon's unprincipled and starkly anticompetitive proposals to deny requesting carriers access to *existing* "broadband" capabilities of *existing* copper loop plant that reflect only sunk investments or the continued deployment of existing technologies in well-proven architectures. There plainly are no "investment incentive" advantages to be had in restricting requesting carriers' rights to use unbundled network elements to provide services that can be supported by the bandwidth available from today's loop plant.

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[36] *See Verizon*, 122 S. Ct. at 1675-76; AT&T Reply Comments, Willig Reply Dec. ¶¶ 80-104 (CC Docket 01-338, filed July 17, 2002); Willig, Lehr, Bigelow & Levinson, *Stimulating Investment and the Telecommunications Act of 1996* ("Willig *et al.* Econometrics White Paper") (attached to Ex Parte Letter from C. Frederick Beckner III (AT&T) to Marlene Dortch (CC Docket 01-338, filed Dec. 11, 2002)).

Thus, even if the Bells' broadband investment incentive theory was accepted at face value, it would be patently arbitrary to set a cap on the bandwidth available to requesting carriers that is lower than the bandwidth capabilities of typical efficient loop plant. The Bells, like other rational economic actors, base investment decisions on *expected* incremental costs and benefits. A Bell decision to extend fiber closer to its residential customers' premises, for example, would reflect the determination that revenues from the new or improved services that the bandwidth-enhancing upgrade would permit would provide an adequate return on that investment. That decision would *not* turn on sunk investments in existing facilities or obligations to share existing capabilities of those existing facilities. For that reason, capping unbundled loop bandwidth at the bandwidth capability of existing loop plant at the time the investment is made would fully satisfy even the most ambitious broadband investment incentive theory – the incumbent would have no obligation to unbundle, and would retain all revenues attributable to, the new bandwidth enabled by the new investment.[37]

For the same reason, any lower bandwidth limit would be patently arbitrary and overbroad, sacrificing demonstrated impairment and competition for no gain in investment. "In law as well as logic, there must be a clear and direct relationship demonstrated between the articulated grounds" for an agency's ruling and a "legitimate governmental interest. Absent [such] a nexus, [the agency] action must be condemned as arbitrary and capricious for want of a discernible rational basis."[38] Thus, the courts have not hesitated to reverse the Commission when there is no "rational connection" between the rules it adopts and the policies upon which those rules are purportedly based.[39]

Verizon's various proposed bandwidth caps are all much lower than existing loop capabilities, and are, therefore, entirely disconnected from the stated goal to give incentives to invest in new facilities to provide new and unproven services. Consensus industry technical standards recognize, for example, that a "clean" copper loop (*i.e.*, a loop without excessive

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[37] If anything, drawing the line at new investment is overly generous to the Bells. The Bells began deploying optical fiber in their networks long before there was any focus on broadband services, because the cost and technical characteristics of optical fiber make it the preferred technology to carry traditional voice and data services in some portions of any efficient local network. Many assertedly "new" Bell fiber investments in fact reflect already planned initiatives to support existing services that are justified on cost savings alone and for which no broadband investment incentive claim is possible. *See* SBC Investor Briefing, *SBC Announced Sweeping Broadband Initiative*, (Oct. 18, 1999) (stating that the "capital and expense savings" of fiber deployment will total "$1.5 billion annual[ly] by 2004" and that such savings alone "will pay for the entire initiative on NPV [net present value] basis"); *see also* AT&T, CC Docket No. 01-338, at 81-82 (filed April 5, 2002).

[38] *Hoska v. U.S. Dep't of Army*, 677, F.2d 1131, 137 (D.C. Cir. 1982).

[39] *See, e.g.*, *Time Warner Entertainment Co v. FCC*, 240 F.3d 1126, 1137 (D.C. Cir. 2001); *Action for Children's Television v. FCC*, 852 F.2d 1132, 1342 (D.C. Cir. 1988). *See also Motor Vehicles Mfrs. Assn'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 42 (1983) ("the agency must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made").

bridge taps and subjected to well understood binder group management) of up to 12,000 feet – and only a small minority of the Bells' loop contain more than 12,000 feet of copper – can support DSL transmission of more than 6 Mbps.[40] To be sure, the Bells artificially cap the downstream transmission speeds of most of the DSL-based services they market today at 1.5 Mbps or less, but that does not change the fact that the *existing* copper plant can generally support much higher transmission speeds.

Of course, not every loop is "typical." Some short copper loops can support transmission speeds of greater than 40 Mbps today. And the Bells have substandard loops as well. The Bells' decisions to defer maintenance and investment to improve short-term profits has resulted in situations where: (i) some loops are not "clean;" (ii) a small minority of loops contain more than 12,000 feet of copper; and, (iii) some loops contain older generation DLC that limits DSL capabilities.

That said, it would be entirely inappropriate to base a bandwidth cap designed to preserve incentives to carry out new and innovative investment projects on the capabilities of these *sub*standard loops, rather than on typical loop capabilities. Any program to invest in increased loop plant bandwidth will presumably reflect the Bell's determination that the typical characteristics of its existing loop plant and available equipment cannot support services that it wishes to offer. Such decisions are not made on a loop-by-loop basis but on a much more aggregated basis. Moreover, unusually long loops, bridge-tapped loops and DLC-equipped loops are scattered throughout an incumbent's serving area. The goal of an upgrade, however, is to increase the bandwidth of *typical* loop plant enough to support new services.[41] And with unbundled loop bandwidth capped at the capabilities of typical existing loop plant, only the incumbent would be able to obtain (at economic cost) the bandwidth necessary broadly to market and provide the new high bandwidth services to consumers.[42]

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[40] *See, e.g.,* http://www.ikanos.com/news/pdfs/091602_cnet.pdf (describing equipment that supports "speeds of over 52 Mbps downstream and over 26 Mbps upstream on a single pair of copper wires") and http://www.nec.co.jp/access/en/solution/vdsl/ (describing equipment for broadband services with 51.2 Mbps communications).

[41] For example, more than three quarters of the Bells' "analog" copper loops can carry high-speed DSL-based services. And for the minority of loops that do not today support DSL (*e.g.*, because of their length or the presence of digital loop carrier), equipment manufacturers already provide the Bells with proven solutions and the Bells already have ample incentives to make, and are, in fact, making, the necessary investments to support those services.

[42] Moreover, any rational bandwidth cap rule would also have to reflect the fact that the bandwidth capability of existing loop plant is not static, but a function of the available electronics. Analog copper loops that could not support megabit service only a decade ago now support multi-megabit services solely as a result of technology advances in signal processing techniques made by manufacturers of electronic equipment. Such advances can be expected to continue, so that the bandwidth capacity of existing copper plant may well increase even if the Bells make *no* additional fiber investments.

Preventing competing carriers from making full use of existing loop capabilities would be patently irrational (and unlawful) for an additional reason as well. The stated goal in limiting unbundling in the face of demonstrated impairment is the actual *delivery* of faster and better advanced services to consumers. Bell investment is not an end in itself and certainly not a legitimate governmental interest. And establishing a bandwidth cap lower than the capabilities of existing loop plant would seriously *undermine* the goal of accelerating the delivery of new advanced services to consumers by denying to competing carriers regulated access to the capacity they need to deliver those services. That would be an exceedingly high price to pay, because experience confirms that competing carriers are much more likely than the Bells to exploit the full capabilities of existing plant (and to price the resulting advanced services competitively).[43] Thus, the cramped broadband use restrictions that Verizon seeks do not merely stray far beyond implementation of the stated goal of accelerating the delivery of advanced services, they are affirmatively at war with that goal.

Finally, it would also clearly be arbitrary and capricious to apply *any* incentive-based bandwidth cap to loops other than the two-wire loops used to serve residential consumers. There can simply be no claim that existing unbundling rules have inhibited the deployment of fiber to serve businesses. The Bells have already extensively deployed fiber in the loop plant to serve business customers, and in the case of medium and large businesses, the Bells typically provide service using all-fiber loops. Because the incumbents have no legitimate need for additional incentives to "upgrade" that plant, there is no basis to ignore or override the significant impairments competing carriers would face without access to those facilities.

Indeed, Verizon effectively concedes that denying access to DS1-capable loops cannot be justified on the basis of investments incentives when it says that this issue can be "address[ed] separately."[44] Instead, Verizon falls back on its argument that where the Commission has granted special access pricing flexibility, competitive carriers cannot be considered impaired without access to high capacity loops used to serve businesses.

The Commission has already properly rejected this argument.[45] And with good reason. The Bells gained pricing flexibility deregulation on the basis of predictive judgments that widespread facilities-based alternatives would develop. The Commission expressly disclaimed

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[43] The Bells delayed deployment of even the most basic DSL capabilities for years after they were available; it was only when the Bells faced *both* intermodal and intramodal competition that they became serious about deploying DSL-based services. *See*, *e.g.*, FCC Cable Services Bureau, *Broadband Today*, 27 (Oct. 1999) ("Although ILECs have possessed DSL technology since the 1980s, they did not offer the services, for concern that it would negatively impact their other lines of business").

[44] *1/17/03 Verizon Broadband Ex Parte* at 8.

[45] *See UNE Remand Order* ¶ 341 n.673 (pricing flexibility triggers do not "describe market conditions where requesting carriers would not be impaired without access to unbundled transport"). Indeed, the Commission *expressly found* in the *Pricing Flexibility Order* that, even after the triggers have been satisfied, the Bells continue to have market power with respect to the relevant services. *Pricing Flexibility Order* ¶¶ 90, 151.

making any finding that competitive carriers had actually deployed last-mile loops to customers, but instead predicted that where a competitive carrier had deployed bypass transport, that carrier would "extend its own facilities to reach its customers."[46] AT&T and other special access purchasers have now conclusively demonstrated that this predictive judgment was wrong.[47] The evidence shows that competitive carriers have deployed last-mile high-capacity loops to only a small fraction of the buildings served by the incumbent LECs, and then only for the customers that require the highest capacity facilities. There is virtually *no* third party supply (or self-supply) of DS-1 loops.[48] And because there are no alternatives, the Bells have been able to raise substantially their special access rates where they have been granted pricing flexibility.

In sum, the Bells' proposed broadband use restrictions are unsupported and unlawful. Competitive carriers are unquestionably impaired without access to the broadband capabilities of typical existing loop plant, and broadband investment cannot justify denying competitive carriers access to those capaAndrosbilities.

[46] *Id*. ¶ 158.

[47] *See generally Ex Parte* Letter from Robert Quinn (AT&T) to Marlene Dortch (filed Oct. 16, 2002) (attaching AT&T Petition (RM No. 10593, filed Oct. 15, 2002) ("AT&T Special Access Petition")); *Ex Parte* Letter from Frank Simone (AT&T) to Marlene Dortch (filed Jan. 30, 2003) (attaching AT&T Reply Comments (RM No. 10593, filed January 23, 2002) ("AT&T Special Access Reply")).

[48] AT&T Special Access Petition, Thomas Decl. ¶ 3; AT&T Special Access Reply at 12-13.

Sincerely,

/s/ David L. Lawson

David L. Lawson

cc: Chairman Michael K. Powell
Commissioner Kathleen Q. Abernathy
Commissioner Jonathan S. Adelstein
Commissioner Michael J. Copps
Commissioner Kevin J. Martin
Marsha MacBride
Christopher Libertelli
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